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Examination and Compliance Check Processes For Exempt Organizations

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The Internal Revenue Service has a variety of tools at its disposal to make certain that tax-exempt organizations comply with federal law designed to ensure they are entitled to any tax exemption they may claim.

The responsibility for administering these procedures belongs to the Exempt Organizations (EO) function, which is part of the IRS's Tax Exempt and Government Entities (TE/GE) Operating Division.

Examinations vs. Compliance Checks

A review of a tax exempt organization falls into two broad categories: compliance checks and examinations.

The IRS conducts examinations, also known as audits, which are authorized under Section 7602 of the Internal Revenue Code. An examination is a review of a taxpayer's books and records to determine tax liability, and may involve the questioning of third parties. For exempt organizations, an examination also determines an organization's qualification for tax-exempt status.

EO conducts two different types of examinations: correspondence and field examinations.

A compliance check is a review to determine whether an organization is adhering to recordkeeping and information reporting requirements and is not an examination since it does not directly relate to determining a tax liability for any particular period.

Correspondence Examinations

Correspondence examinations are limited in scope and focus on only one or two items on a return. An EO specialist typically conducts the examination through letters and phone calls with the organization's officers or representatives.

If the issues become complex, or if the organization does not respond to a letter or call, EO may require the officers or representatives to bring records to an IRS office. EO may also convert a correspondence examination into a field examination.

Field Examinations

A field examination is one conducted by a revenue agent at the organization's place of business. Generally, these audits are the most comprehensive. There are two distinct types of EO field examinations – EO Team Examination Program (TEP) and EO General Program.

- EO TEP examinations are field examinations of large, complex organizations that may require a team of specialized revenue agents, as well as coordination between IRS functions and other governmental agencies. They are often conducted using coordinated team examination approaches and procedures.
- EO General Program examinations are typically performed by individual revenue agents. They usually do not require a team of specialists.

A field examination usually begins when the revenue agent notifies the organization that its return has been selected for examination. This initial contact is by telephone or by letter to schedule an initial appointment. The organization receives Publication 1, *Your Rights as a Taxpayer*, with the appointment letter.

In the appointment contact, the revenue agent will typically request the following documents to begin the audit:

1. Governing instruments (articles of incorporation, charter or constitution, including all amendments; and bylaws, including all amendments),
2. Pamphlets, brochures, and other printed literature describing the organization's activities,
3. Copies of the organization's Forms 990 for the years before and after the year under examination,
4. For the year under examination (at a minimum):
 - Minutes of meetings of the board of directors and standing committees or councils,
 - All books and records of assets, liabilities, receipts and disbursements,
 - Auditor's report, if any,
 - Copies of other federal tax returns filed and any related workpapers (Form 990-T for taxable income, Form 1120-POL for political activity, etc.),
 - Copies of employment tax returns and any related workpapers (Forms W-2, W-3, 941, 1096, 1099).

(Note: Many of these records may also be required for a correspondence examination.)

During an opening conference with the organization's officers or representatives, the revenue agent explains the audit plan and the reason the organization has been selected for examination. The revenue agent usually conducts a comprehensive interview and tours the organization's facilities to gain a basic understanding of the organization's purposes and activities.

The examination of a tax-exempt organization is multifaceted and includes a review of its operation and activities to verify the existence of an exempt purpose, as well as a review of financial records. The length of the examination will depend upon a variety of factors, such as the size of the organization, the complexity of its activities and the issues that may arise during the examination. Some audits can be completed in just a few days; others can last for a year or more.

A field examination typically concludes with a closing conference. The revenue agent will discuss the audit with the organization's representatives, and if necessary, furnish a report explaining proposed adjustments to the organization's returns or exempt status. If the revenue agent and the organization's representatives disagree on the findings, the organization may request a meeting with the revenue agent's manager to discuss the disagreement. If the manager cannot resolve the differences, the organization may pursue its case through the IRS appeals process. For additional information on the appeals process, see Publication 892, *EO Appeal Procedures for Unagreed Issues*.

Compliance Checks

Exempt Organizations also maintains an active compliance check program. EO specialists conduct the checks by corresponding with or telephoning exempt organization representatives. A specialist may inquire about an item on a return, determine if specific reporting requirements have been met or whether an organization's activities are consistent with its stated tax-exempt purpose.

An officer or representative of an exempt organization may refuse to participate in a compliance check without penalty. However, EO has the option of opening a formal examination, whether or not the organization agrees to participate in a compliance check.

At the beginning of a compliance check, the specialist will inform the officer or director that the review is a compliance check and not an examination. The specialist will not ask to examine any books or records or ask questions regarding tax liabilities. The specialist may ask whether the organization understands or has questions about filing obligations for required forms. The specialist may also ask questions about the organization's activities. If, during a compliance check, the specialist decides an examination is appropriate, he or she will notify the organization that EO is commencing an examination before asking questions related to tax liability.

Because a compliance check only reviews whether an organization is adhering to record keeping and information reporting requirements or whether an organization's activities are consistent with its stated tax-exempt purpose and is not an examination, it is possible to have more than one compliance check for a tax year if facts and

circumstances warrant. For more information, see Publication 4386, *Compliance Checks*.

Selecting Organizations for Examination or Compliance Checks

EO strives to ensure consistency and fairness in its examination and compliance check processes. In its annual *Implementing Guidelines*, which are available on the IRS website at www.irs.gov/eo, EO describes its proposed examination and compliance check activities for the year.

EO designs and implements comprehensive projects to address issues that carry the most non-compliance risk. To determine which organizations should be targeted, experienced specialists analyze information from Forms 990 and other sources. This analysis will usually result in the selection of a group of returns for examination or compliance check.

EO also reviews media reports and receives complaints from the general public and Congress about potential non-compliance by exempt organizations. After confirming the information, and when appropriate, these organizations may be selected for examination or to receive a compliance check. For details on how EO handles complaints about exempt organizations, see Fact Sheet 2008-11.

Regardless of the process used to select returns, EO does not presume that an organization is violating the tax laws before it begins the examination or sends a compliance check letter.